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In Re:

Department of the Treasury
Washington, DC 20224

Third Party Communication: None
Date of Communication: Not Applicable

Person To Contact: _____, ID No. _____

Telephone Number:

Refer Reply To:
CC:CORP:B01
PLR-147773-06

Date:
April 06, 2007

LEGEND:

Distributing =

Controlled =

Affiliate =

FSub1 =

FSub2 =

FSub3 =

Shareholder 1 =

Shareholder 2 =

Business 1 =

Business 2 =

Company A =

Company B =

Company C =

State A =

State B =

State C =

State D =

Country X =

Country Y =

Country Z =

Year A =

Year 1 =

Date 1 =

Date 2 =

Date 3 =

Date 4 =

A =

B =

C =

D =

E =

F =

G =

H =

Dear :

This letter responds to your September 30, 2006, letter requesting rulings as to the federal income tax consequences of a series of proposed transactions. The information submitted in that request, and in later correspondence, is summarized below.

The rulings contained in this letter are based on facts and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. This office has not verified any of the materials submitted in support of the request for rulings. Verification of the information, representations, and other data may be required as part of the audit process. Moreover, no information provided by the taxpayer has been reviewed and no determination has been made regarding whether the proposed transaction: (i) satisfies the business purpose requirement of Treas. Reg. § 1.355-2(b); (ii) is used principally as a device for the distribution of earnings and profits of the distributing corporation or the controlled corporation or both (see §355(a)(1)(B) of the Internal Revenue Code and Treas. Reg. §1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which

one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in the distributing corporation or the controlled corporation.

Description of facts and proposed transaction:

Shareholder 1 and Shareholder 2 organized Distributing under State A law in Year 1 with one class of common stock issued and outstanding, held 50 percent by Shareholder 1 and 50 percent by Shareholder 2 since inception. Shareholder 1 and Shareholder 2 made an S election for Distributing under section 1362 of the Code, effective as of the beginning of its first taxable year. Shortly after formation, Distributing acquired its business assets by purchase from an unrelated seller and commenced business. Distributing has been engaged in Business1 and Business 2 at facilities in State A, State C, and State D for more than 5 years (collectively, the “Domestic Business”).

Affiliate was organized under State C law in Year A (prior to Year 1) with Shareholder 1, its sole shareholder, making a timely election S election for Affiliate, effective as of the beginning of Affiliate’s first taxable year. Although Affiliate began operations in Year A, its operations subsequently ceased, with Affiliate held as a “shell” corporation for some time thereafter. In Year 1, Affiliate issued stock to Shareholder 2, with Shareholders 1 and 2 each then becoming 50-percent shareholders of Affiliate. That same year, in connection with Distributing’s acquisition of business assets by purchase, Affiliate acquired certain related real properties by purchase.

On Date 1, Distributing and Affiliate acquired B and C percent, respectively, of the stock of FSub1, a Country X corporation that was an inactive “shell,” from unrelated sellers for nominal consideration. Shortly thereafter, FSub1 acquired all the stock of FSub2 by purchase from unrelated sellers for \$D. Of the \$D, approximately \$E had been contributed to the capital of FSub1 by Distributing and Affiliate and \$F had been loaned to FSub1 by Distributing in exchange for FSub1’s note (the “FSub1 Note”). The FSub1 Note is a demand note bearing interest at the rate of G percent per year.

For U.S. tax purposes, the taxpayer treated FSub1 as a partnership and FSub2 as a disregarded entity, pursuant to elections under Treas. Reg. §301.7701-3(c) made on Form 8832. FSub2 owned and continues to own A percent of the stock of FSub3, a Country Y corporation, that has been treated as a partnership for U.S. tax purposes pursuant to an election on Form 8832. FSub2 conducts substantial management and control over the operations of FSub3. FSub2 and FSub3 each directly conduct both Business 1 and Business 2, in Countries X and Y, respectively (the business of FSub1, FSub2 and FSub3, collectively, the “Foreign Business”).

On or about Date 2, Distributing acquired the assets of Company A and Company B in a private foreclosure sale for use in the Domestic Business.

On or about Date 3, Affiliate was merged into Distributing in a transaction intended to qualify as a tax free reorganization under section 368(a)(1)(A) of the Code, with Distributing becoming the 100 percent owner of FSub1, which thereafter was treated as a disregarded entity for U.S. tax purposes.

The taxpayer has submitted financial information indicating that each of Business 1 and Business 2 conducted by Distributing has had gross receipts and operating expenses representing the active conduct of a trade or business for each of the past five years.

The taxpayer intends to expand its business activities. To this end, Distributing is currently investigating the possibility of acquiring by purchase (the “Foreign Asset Purchase”) certain of the operating assets, subject to certain of the operating liabilities, of Company C, a Country Z corporation, for use in its foreign operations. If Distributing were to consummate the Foreign Asset Purchase (or a comparable transaction) in the absence of the transaction proposed below, the number of employees of Distributing would exceed the number permitted for Distributing to continue to qualify as a “small business” supplier to the U.S. federal government, causing revocation of Distributing’s qualification as a “small business” and thereby resulting in substantial revenue loss. Distributing desires to enter into the proposed transaction in order that Distributing may continue to qualify and Controlled may qualify as “small business” suppliers to the U.S. federal government, while at the same time allowing for the possibility of future expansion, such as that represented by the Foreign Asset Purchase.

Accordingly, the taxpayer proposes to vertically divide Distributing’s business (Business 1 and Business 2) on the basis of geographic location (the “Proposed Transaction”) by (i) contributing the Foreign Business and associated liabilities (i.e., contributing all of the stock of FSub1) to Controlled, along with the FSub1 Note and the Value Equalization Note (described below), in exchange for all of the Controlled stock (the “Contribution”), and, on the same day, (ii) distributing all the Controlled stock to Shareholder 1 in exchange for all of Shareholder 1’s stock in Distributing (the “Distribution”). Controlled will be a newly-organized corporation having a single class of stock outstanding.

As part of the Contribution, two steps will be taken to insure that the values of Distributing and Controlled immediately after the Distribution will be equal—(1) Distributing will contribute the FSub1 Note to the capital of Controlled, and (2) Distributing will issue its promissory note to Controlled (the “Value Equalization Note”) in a principal amount equal to 50 percent of the value differential between the Domestic Business and the Foreign Business as determined after taking into account Distributing’s contribution of the FSub1 Note to Controlled. The Value Equalization Note will bear interest at a market rate approximating the interest rate available to Distributing from its third-party lenders and be payable in monthly interest only

payments for a period of five years, with a balloon payment due at the end of the five-year period.

Taxpayer makes the following representations regarding the Proposed Transaction:

(a) The fair market value of the Controlled stock and other consideration to be received by Shareholder 1 in the Distribution will be approximately equal to the fair market value of Distributing stock surrendered by Shareholder 1 in the exchange.

(b) No part of the consideration to be distributed by Distributing will be received by a shareholder as a creditor, employee, or in any capacity other than that of a shareholder of Distributing.

(c) The five years of financial information submitted on behalf of Distributing is representative of the corporation's present operation, and with regard to such corporation, there have been no substantial operational changes since the date of the last financial statements submitted.

(d) Following the Proposed Transaction, Distributing and Controlled will each continue, independently and with its separate employees, the active conduct of its share of all the integrated activities of the business conducted by Distributing prior to consummation of the Proposed Transaction.

(e) The distribution of the stock, or stock and securities, of Controlled is carried out for the following corporate business purpose: to allow the expansion of the historic businesses of Distributing without loss of Distributing's qualification as a small business supplier under the applicable federal rules for U.S. government procurement and to allow Controlled to qualify as a separate small business supplier under the applicable federal rules. The distribution of the stock, or stock and securities, of Controlled is motivated, in whole or substantial part, by these corporate business purposes.

(f) The Proposed Transaction will not be used principally as a device for the distribution of the earnings and profits of Distributing or Controlled or both.

(g) Not taking into account the FSub1 Note and the Value Equalization Note, the total adjusted bases and the fair market value of the assets transferred to Controlled by Distributing will each equal or exceed the sum of the liabilities assumed by Controlled plus any liabilities to which the transferred assets are subject.

(h) The liabilities assumed in the Proposed Transaction and the liabilities to which the transferred assets are subject were incurred in the ordinary course of business and are associated with the assets being transferred.

(i) Distributing neither accumulated its receivables nor made extraordinary payment of its payables in anticipation of the Proposed Transaction.

(j) With the exception of the Value Equalization Note, no intercorporate debt will exist between Distributing and Controlled at the time of, or subsequent to, the distribution of Controlled stock.

(k) Payments made in connection with all continuing transactions, if any, between Distributing and Controlled, will be for fair market value based on terms and conditions arrived at by the parties bargaining at arm's length.

(l) No two parties to the transaction are investment companies as defined in section 368(a)(2)(F)(iii) and (iv) of the Code.

(m) Distributing is an S corporation (within the meaning of section 1361(a) of the Code). Controlled will elect to be an S corporation pursuant to section 1362(a) of the Code on the first available date after the distribution and there is no plan or intent to revoke or otherwise terminate the S corporation election of either Distributing or Controlled.

(n) The Proposed Transaction is not part of a plan or series of related transactions (within the meaning of Treas. Reg. §1.355-7) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest (within the meaning of §355(d)(4)) in Distributing or Controlled (including any predecessor or successor of any such corporation).

(o) Distributing has had a valid S-election in effect since the beginning of its first taxable year, has no current or accumulated earnings and profits, and no assets subject to section 1374 of the Code.

(p) Affiliate had a valid S-election in effect since the beginning of its first taxable year, had no current or accumulated earnings and profits at any time, and no assets subject to section 1374 of the Code.

(q) As of Date 4, Distributing's adjusted basis in the FSub1 Note, the adjusted issue price of the FSub1 Note and the fair market value of the FSub1 Note each equaled \$H.

(r) Distributing is not a U.S. real property holding corporation (as defined in section 897(c)(2) of the Code).

(s) No foreign person will own stock in Distributing before or after the distribution.

(t) FSub1, FSub2 or FSub3 are not currently nor will they be passive foreign investment corporations as defined in section 1297(a) of the Code.

(u) FSub1, FSub2 or FSub3 are not currently nor will they be controlled foreign corporations as defined in section 957 of the Code.

Based solely on the information submitted and the representations set forth above, we rule as follows on the proposed transactions:

(1) The Proposed Transaction will qualify as a reorganization described in §368(a)(1)(D). Each of Distributing and Controlled will be a “party to the reorganization” within the meaning of §368(b).

(2) No income, gain or loss will be recognized by Distributing in connection with the Contribution. §361(a).

(3) No income, gain or loss will be recognized by Controlled in connection with the Contribution. §1032(a).

(4) Immediately following the Contribution, Controlled’s basis in each applicable asset it receives in the Contribution will equal the basis of that asset in the hands of Distributing immediately before the contribution. §362(b).

(5) Controlled’s holding period for each applicable asset it receives in the Contribution will include the period during which Distributing held that asset prior to the Contribution. §1223(2).

(6) No income, gain or loss will be recognized by Distributing with respect to the Distribution. §361(c).

(7) No income, gain or loss will be recognized by Shareholder 1 upon receipt of the Controlled common stock in the Distribution. §355(a).

(8) The basis of the Controlled common stock in the hands of Shareholder 1 will be the same as the basis of the Distributing common stock surrendered in exchange therefor. §358(a).

(9) The holding period of the Controlled common stock received by Shareholder 1 in the Distribution will include the holding period of the Distributing common stock surrendered in exchange therefor, provided the Distributing common stock was held as a capital asset on the date of the Distribution. §1223(1).

(10) Distributing’s momentary ownership of the stock of Controlled, as part of the reorganization under section 368(a)(1)(D), will not cause Controlled to have an ineligible

shareholder for any portion of its first taxable year under section 1361(b)(1)(B) of the Code. If Controlled otherwise meets the requirements of a small business corporation under section 1361, Controlled will be eligible to elect to be a subchapter S corporation under section 1362(a) for its first taxable year.

CAVEATS

We express no opinion about the tax treatment of the proposed transactions under other provisions of the Code and regulations or the tax treatment of any conditions existing at the time of, or effects resulting from, the proposed transactions that are not specifically covered by the above rulings. In particular, no opinion is given regarding—(A) whether the Distribution (i) satisfies the business purpose requirement of Treas. Reg. §1.355-2(b); (ii) is used principally as a device for the distribution of earnings and profits of Distributing or Controlled or both (see §355(a)(1)(B) of the Internal Revenue Code and Treas. Reg. §1.355-2(d)); or (iii) is part of a plan (or series of related transactions) pursuant to which one or more persons will acquire directly or indirectly stock representing a 50-percent or greater interest in Distributing or Controlled, (B) the federal income tax treatment of the Proposed Transaction under sections 367, 897, 1248 or 1445 of the Code, (C) any tax effects relating to Distributing's transfer of the FSub1 Note to Controlled, other than those provided for in the rulings given above, and (D) the basis of the Value Equalization Note.

PROCEDURAL STATEMENTS

This ruling letter is directed only to the taxpayers who requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

A copy of this letter must be attached to any income tax return to which it is relevant. Alternatively, any taxpayer filing its return electronically may satisfy this requirement by attaching a statement to the return that provides the date and control number of this letter ruling.

In accordance with the power of attorney on file in this office, a copy of this ruling letter will be sent to your authorized representative.

Sincerely,

Lisa Fuller
Senior Counsel, Branch 1
Office of Associate Chief Counsel (Corporate)

cc: